

8. Depreciation and Amortization

a. Depreciation and Amortization Expense

Depreciation is the largest expense, \$703,705,702, on Ameritech's operating income statement, Ameritech Ex. 7.3, Schedule 1. Ameritech proposed a depreciation adjustment which expense in the amount of \$101,657,000. Ameritech Ex. 7.1, Sched. 1, col. E. Ameritech admitted to claiming a depreciation in three (3) accounts¹⁰ that had were already fully depreciated. Ameritech Ex. 7.1 at 4. Staff concurs both with the adjustment, and the method used in calculating the adjustment. Staff Ex.24.0 at line 126. Immediately prior to the hearing in this docket, Ameritech redid the calculations to determine the adjustment for over depreciated accounts and reduced the adjustment to \$95,947,547. Ameritech Ex. 7.3, Schedule 5. Staff believes that this adjustment is not reasonable, it is less accurate than the previous calculation and Staff's calculation because Ameritech used weighted intrastate factors and averaged nonregulated factors when it recalculated the adjustment. See id. Therefore, the more accurate adjustment for the over depreciated accounts is the original value of \$101,657,000. Although, Staff recommends that its value \$101,656,920 is more accurate for the reasons discussed above and in Staff's Initial Brief on page 99. Therefore Staff's value is more reasonable than Ameritech's proposed adjustment/correction.

Additionally, Ameritech improperly claimed adjustments for amortizing circuit equipment and Other Freedom. Ameritech claims that the Commission authorized an \$11,242,000 amortization for Circuit Equipment in Docket 92-0448/93-0239 (consol.),

¹⁰ Account 2211 – Analog Switching; Account 2124 – General Purpose Computers; Account 2232.11 – Circuit DDS, totaling \$101.657 million.

and continues to contend that this is an actual expense and should be reported. Ameritech Brief at 101. As stated in Staff's Initial Brief at 99, it has not been determined that the Commission accepted the amortization of circuit equipment, and even if it had, the period for amortization was only five (5) years, and that period expired in 1999. Additionally, the very same argument holds true for the adjustment related to "Other Freedom" for \$32,126,000. Staff IB at 99.. Thus, it is improper to include these amortized accounts in the revenue requirement.

Staff disagrees with GCI witness Dunkel's proposed depreciation adjustment of \$386 million primarily because GCI disputes the use of depreciation freedom, which was granted Ameritech in Docket 92-0448/93-0239 at 196, in a test year. Staff believes that depreciation freedom extends to all years including the test year, and therefore contends that our depreciation adjustment is proper.

In conclusion, the Total Allowable Depreciation Expense for revenue requirement should be **\$558,680,782** as set forth in Staff's Initial Brief on page 99. This requires an reduction of \$49,077,373 from Ameritech's currently proposed Adjusted Intrastate Depreciation Expense of \$607.758 million. Staff IB at 98; see Staff IB Attachment B, page 1. Staff's Total Allowable Depreciation Expense is obtained by subtracting Ameritech's Over Depreciated Accounts (\$101,656,920, as discussed above) and the improper amortization of Circuit Equipment and Other Freedom (\$11,242,000 + \$32,126,000, respectively), from the Ameritech's reported Total Depreciation -- \$703,705,702.

b. Depreciation and Deferred Tax Reserves

Ameritech and GCI propose adjustments to Deferred Income Taxes and Intrastate Depreciation Reserve. Ameritech IB at 128 (citing Ameritech Ex. 7.2 at 3 and Sched. 2); CUB IB at 120 (citing GCI Ex. 6.5 Sched E-2 Revised); Chicago IB at 56. As presented in Staff's Initial Brief Appendix B, p.2, Staff recommends a Depreciation Reserve of \$4,591.149 million and a Deferred Tax Reserve of \$372.255 million.

GCI recommends a Final Accumulated Depreciation Reserve of \$4,426.984 million, Accumulated Deferred Income Tax (the corollary of Staff's Deferred Tax Reserve) of \$453.144 million. GCI Ex. 6.3 Sched. B (revised). Staff varies from GCI because Staff allows depreciation freedom and GCI does not advocate the use depreciation freedom in developing a revenue requirement.

B. Rate Base Adjustments

1. Telephone Plant Under Construction

In response to Staff's proposal on Telephone Plant Under Construction, (hereinafter referred to as "TPUC"), Ameritech claims that Staff's recommendation was inappropriate because Section 9-214(e) of the PUA allows for rate base inclusion of TPUC when construction will be completed and placed in service within 12 months after the rate determination, and that this provision contains no exception for TPUC on which Allowance for Funds Used During Construction ("AFUDC") is accrued. Ameritech IB at 132. Ameritech's argument is baseless, and should be rejected by the Commission because Ameritech has presented no evidence through the many opportunities it had that its TPUC balance meets the aforementioned criteria of Section 9-214(e).

Rather, Staff asserts that the record shows that Ameritech's TPUC falls into the category described by Section 9-214(d) of the PUA, which requires Construction Work in Progress ("CWIP"), also known as TPUC, to be disallowed from rate base, as properly reflected in Staff's adjustment. Staff IB at 104. Both Ameritech's and GCI's adjustments violate this statute, therefore, the Commission should reject them and adopt Staff's adjustment to properly avoid the double recovery of AFUDC in the revenue requirement. Staff IB at 103-105.

In its Initial Brief, CUB incorrectly asserts that Staff witness Hathhorn, in rebuttal testimony, accepted Mr. Smith's thirty-six (36) month methodology to normalize TPUC. CUB Corrected IB at 140. The record is clear, however, that Staff's rebuttal position revised Staff's adjustment from direct testimony, and no longer recommended any normalization, but rather used actual Company numbers to propose a different TPUC adjustment to address the IDC issue. Staff Exhibit 20.0, at 4, 7. Therefore, the Commission should ignore CUB's assertion regarding Staff's rebuttal position on this issue.

C. Cost of Capital

1. Capital Structure – Reply to Ameritech

Ameritech asserts that the Staff's use of the book value capital structure to calculate the overall cost of capital is incorrect. Ameritech claims that in today's more uncertain environment, the overall cost of capital should be determined using market weights. Ameritech IB at 134. Staff would agree that if the Commission were to establish rate of return-based rates on a non-book value measure of rate base, then it

would be appropriate to consider a market-value capital structure.¹¹ However, no party has suggested such an approach. Thus, the record supports measuring rate base on a book value basis only. Moreover, the Commission only uses original cost rate base when setting rate of return-based rates. Therefore, Ameritech's book value capital structure should be used if the Commission uses rate base/rate of return ratemaking procedures to re-initialize Ameritech's rates.

Ameritech witness Avera agrees that book values of the components of the capital structure are appropriate for traditional, original cost ratemaking. Ameritech Ex. 8.1 at 9. Dr. Avera suggests, however, that since Ameritech operates in the competitive sector, book values are no longer appropriate for capital structure measurement. Ameritech Ex. 8.1 at 9. Putting aside the questionable assertion regarding the existing level of competition for either Ameritech's "competitive" or "noncompetitive" services, if rates are set on the basis of original cost rate base/rate of return regulation, book value should be the basis for capital structure measurement to ensure a consistency between rate base and capital structure. Therefore, in the event the Commission orders rate re-initialization for noncompetitive services based on traditional rate base/rate of return regulation, the Commission should reject Dr. Avera's argument and find that a book value capital structure is appropriate for determining Ameritech's weighted average cost of capital.

Ameritech claims, "using a market cost of equity with a book value-weighted capital structure that contains a higher level of debt understates what the cost of equity would be for a capital structure with that higher level of debt and, therefore, understates

¹¹ Nevertheless, a market value capital structure would still be subject to a reasonable cost test. Further, the market value of Ameritech's common equity is a debatable issue since its common stock is

the true market cost of capital." Yet, when Staff's pre-tax interest coverage (PTIC) calculation¹² demonstrated that the cost of Ameritech's market-value capital structure proposal was unnecessarily expensive (i.e., Ameritech's PTIC was too high), Dr. Avera countered with his own calculation that inappropriately mixed market and book value inputs to produce a significantly lower PTIC. Specifically, his calculation combined a numerator containing the pre-tax cost of the market value capital structure with a denominator containing the higher interest expense associated with the book value capital structure. Staff Ex. 25.0 at 6-7; Ameritech Ex. 8.2 at 5. Thus, Ameritech wants it both ways. The Company wants its capital structure proposal to be evaluated on the basis of the interest costs associated with a book value capital structure but wants its rates set or evaluated on the basis of the higher returns associated with a market value capital structure. The inherent inconsistency in this approach needs no further comment; the Commission should reject it.

2. Return on Common Equity

a. Reply to Ameritech

Ameritech asserts that Staff's 20-basis point downward adjustment to its cost of equity range was unnecessary. Ameritech IB fn. 49 at 134. This adjustment was necessary to reflect the less risky position of Ameritech relative to the telecommunications sample as a whole. The average bond rating of the telecommunications sample is in the A range, while Ameritech has a higher AA- rating. Since quantifying the effect of risk on the cost of common equity is problematic, Staff based this adjustment on the approximately 20 basis point difference between long-

not market-traded.

term public utility bond yields rated Aa and A by Moody's. Staff Ex. 11.0 at 29. Therefore, the record clearly supports Staff's 20- basis point downward adjustment to Ameritech's cost of equity.

b. Reply to the Attorney General

The Attorney General ("AG") argues that Ameritech's and Staff's cost of capital testimony did not provide the complete statutory analysis the Commission needs to determine if their respective rate of return recommendations comply with Section 9-230 of the Public Utilities Act. AG IB at 90. However, the AG provides no explanation or description of those alleged deficiencies. To the contrary, Staff's 10.52% recommended cost of capital is in accordance with Section 9-230 since that cost of capital does not include any incremental risk that is the direct result of Ameritech's affiliation with its parent company. First, the record affirmatively shows that the book value capital structure of SBC is quite similar to that of Ameritech as of December 31, 1999. Ameritech Ex. 1.1 at 110-112. Second, the record shows that Standard & Poor's rates the debt of both entities AA-, indicating that Ameritech and SBC are comparable in risk. Staff Ex. 11.0 at 30; Tr. 2231. Third, Staff ensured that its cost of common equity recommendation did not reflect the higher risk of the telecommunications sample as a whole, which includes SBC, by making the 20 basis point downward adjustment, as discussed previously. Staff Ex. 11.0 at 30.

c. Rate Re-initialization

CUB urges adoption of the low end of Staff's proposed return on equity range to re-initialize Ameritech's rates. CUB IB at 78, 80-81. CUB argues that the reasoning the

¹² Pre-tax interest coverage equals the pre-tax cost of capital divided by the weighted cost of debt. Staff Ex. 25.0, Sched. 25.01.

Commission used in the Alt. Reg. Order to set rates, in part, on the low end of Staff's proposed return on equity range is still applicable. CUB IB at 147-146. In contrast, Ameritech asserts that the upper end of the cost of capital range is the appropriate benchmark should the Commission choose to evaluate the Company's earnings performance under the Plan. Ameritech IB at 134-135. The Company's assertion implies that use of the upper end of Ameritech's cost of equity would be more appropriate than either the midpoint or low-end cost of equity estimates in the event the Commission orders rate re-initialization under the Plan. Thus, both CUB's and Ameritech's arguments presuppose some form of rate re-initialization as part of the *continuation of an alternative regulation plan*.

As previously stated, Staff does not support re-initializing Ameritech's rates. Staff IB at 47-49. However, in the event that the Commission rejects that position and decides to re-initialize rates to the rate base/rate of return regulation revenue requirement level, then Staff's midpoint cost of equity estimate, 13.1%, is the appropriate value to use as it encompasses both of the cost of equity methodologies the Commission has long recognized as valid. Staff IB at 117-118. Nevertheless, Staff recognizes that in re-initializing rates, the Commission might determine that deviating from the midpoint estimate of Ameritech's cost of equity would advance the goals for continuing with an alternative regulatory plan. However, as in its Alt. Reg. Order, the Commission should clearly state the reasons for any deviation from Staff's recommended cost of equity for Ameritech. Alt. Reg. Order at 174.

VI. COST OF SERVICE

A. LRSIC Cost of Capital

Staff recommend a capital structure of 60% equity and 40% debt, as set forth in Staff's Initial Brief at 119-22. Based upon this recommendation, the Commission should adopt a weighted cost of capital of 10.75%.

B. Ameritech LRSIC Studies

In its Initial Brief, Ameritech devotes considerable time to presenting arguments that current LRSIC rules understate true incremental costs and that costs should properly account for spare capacity. Ameritech IB at 148. This, however, is not an issue in the proceeding. As Ameritech is fully aware, Illinois Cost of Service rules clearly state that the rate for services should cover LRSIC. 83 Ill. Adm. Code 791. This proceeding is not the proper forum to debate alleged deficiencies in the Cost of Service rules; instead, the proceeding is intended to review the successes and failures of Ameritech's Alternative Regulation Plan, and the merits of its rate rebalancing proposal.

In its Initial Brief, the City of Chicago describes numerous conceptual flaws with Ameritech's cost study. City at 58-71. Likewise, Staff identified programming deficiencies in the LFAM model. It is clear from this evidence that LRSICs developed using Ameritech's LFAM model should not be used in this proceeding. Additionally, Staff witness Green states that in his opinion the LFAM model appears to be engineered for data transmission rather than voice service due to its use of a fiberbreak length of 6,000 feet. Staff Ex. 24.0 at 3. Moreover, the FCC has determined that

12,000 feet is the maximum length over which a copper wire will carry a signal of appropriate quality for voice service without the addition of expensive electronics. In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, CC Docket No. 97-160, ¶68 FCC 98-279 (released: October 28, 1998). The shorter the length of the copper loop the higher the data rate the loop can carry. Staff believes the network modeled in LFAM carries much higher data rates than required by a network access line for voice service. Although Staff does not dispute the proposition that the LFAM model's 6,000 foot loop assumption is "forward-looking", or that bandwidth management is easier using fiber rather than copper plant, this configuration is considerably more sophisticated, and costly, than is necessary to provide the service in question, i.e. plain old telephone service (POTS).

This over-elaborate assumption regarding the network is significant. Ameritech urges the Commission to accept the assertion that, in an industry in which it is widely accepted that costs are declining, Ameritech's costs for network access have *increased* by one-third to one-half, or alternatively that it has been understating its costs by one-third to one-half,. The Commission, having dealt with Ameritech cost studies in the past, and having determined that such studies rarely if ever err on the side of under-recovery, should reject this proposal.

Ameritech has the burden to justify its proposed rates. 220 ILCS 5/9-201 (c). It has not done so; if anything, the proceeding has cast a significant degree of doubt upon the LRSICs Ameritech has produced in support of its proposed rate increase for residential network access lines. Accordingly, the Commission should decline to permit

their use in this proceeding. Ameritech has, quite simply, failed to demonstrate that rate rebalancing is necessary. To the extent that the Commission determines that it might be, Staff recommends that the LRSICs from the Company's 2000 Aggregate Revenue Test be adopted for use in this proceeding for any rate rebalancing, or if the Commission should elect to reinitialize rates.

VII. RATE DESIGN

A. Rate Rebalancing

Ameritech asserts that its rate rebalancing plan responds to changes in the marketplace since 1994 and moves toward market-based prices. Ameritech IB at 10. Ameritech refers to changes it proposes as "long overdue." Ameritech IB at 11. Staff notes that, in order to justify that residential loop rate increases are necessary, the focal point of Ameritech's proposal, Ameritech relies on recently revised cost models. Staff is critical of these adjustments, but notes that Ameritech's argument indicates that its past modeling deficiencies did contribute to deficiencies in its rate structure.

The rationale Ameritech uses to justify its rate rebalancing proposal is disjointed and inconsistent. Ameritech's primary argument in favor of the proposal is that the proposal is necessary in order to correct inefficiency in its current rate structure. Ameritech IB at 10. As Staff noted in its Initial Brief, components of Ameritech's rate rebalancing proposal are completely at odds with Ameritech's own stated notions of efficiency. Staff IB at 129. Ameritech continues, in its Initial Brief, to offer disjointed and inconsistent justification for its rate rebalancing proposal.

Ameritech argues that efficiency justifies increasing residential access line rates, so that such rates are in line with costs. Ameritech IB at 139. In fact, however, Ameritech's proposal attempts to increase residential access line rates to recover other non-recurring costs, such as incremental service ordering, and installation costs incurred to provision access lines. This is evident in Ameritech's Initial Brief, where it argues "these costs slightly exceed current service ordering and installation (non-recurring) charges. The shortfall needs to be recovered in the recurring rates for access lines." Ameritech IB at 137. Because this aspect of the proposal actually increases the disparity between the rate structure and Ameritech's costs it is completely at odds with the very notions of efficiency Ameritech advocates¹³. Efficiency requires that rates match costs. Since installation costs are non-recurring, the rate for the service to recover those costs should be non-recurring. If these costs were allowed to be recovered via a monthly recurring charge, customers who keep Ameritech network access line service for a long time will overpay the costs. Conversely, customers who keep service for a short time will underpay the cost of the service. This is not economically efficient.

Furthermore, Ameritech clearly does not take its own notions of efficiency very seriously; its proposal includes a provision that would exacerbate these inefficiencies by further reducing current service ordering and installation (non-recurring) charges. Ameritech IB at 142.

¹³ In response to the question: "Do you agree that both equity and efficiency should be guiding principles in setting rates as Dr. Zolnierrek says?" Ameritech witness replied, in part: "There is only one efficient solution available to the Commission, and that is where the marginal rate of substitution in consumption equals the marginal rate of transformation with the current distribution of income and wealth. This is interpreted in policy settings as the price-equals-marginal/incremental cost rule." Ameritech Ex. 4.2 (Harris Rebuttal Testimony) at 34.

Ameritech's support for other aspects of its rate rebalancing proposal are even less coherent. For example, Ameritech argues that its reduction of Band B rates is a response to the company's perception that "consumers would like to see the Band B rate structure move in the direction of the Band A per call structure." Ameritech IB at 143. Similarly Ameritech's argument for lowering pay per use features is that such features are priced too high in relation to the monthly subscription rates for these services. Ameritech IB at 143.

Ameritech's failure to provide an efficient proposal that meets the stated equity goals of the Commission is grounds for dismissal. If the Commission continues with the alternative regulation plan as Staff recommends, then any rate rebalancing proposal must comport to this system. With revenue neutrality factoring as a critical element of the proposal, Ameritech's rate rebalancing plan must be assessed in its entirety. Taken as a whole, Ameritech's rate rebalancing plan is clearly deficient and should be rejected.

Throughout this proceeding, Staff has indicated that it supports cost based rates. See Staff Ex. 3.0 at 17.0. Further, in contrast to Ameritech's assertions, Staff concurs with Ameritech that universal service concerns should be addressed through explicit subsidy plans and not through rate structure.¹⁴ See Staff Ex. 3.0 at 24. Therefore,

¹⁴ Ameritech asserts that Staff's notion of equity reflects its concern for universal service. See Ameritech IB at 140. Staff, however, has dispelled that notion. See Staff Ex. 3.0 at 24. Under the price cap system, Ameritech is allowed to recover revenues in excess of costs. Furthermore, Ameritech has some latitude to adjust its rate structure across services that vary in their degree of competitiveness. Staff notes that under such conditions the Commission must be cognizant of equity concerns, for example that captive customers are not subsidizing other customers, when evaluating proposals to rebalance rates. In fact, it is duplicitous of Ameritech to make such arguments, when it employs these exact universal service arguments to support an inefficient component of its own rate rebalancing proposal. See Ameritech IB at 142.

Staff has proposed an alternative to Ameritech's rate rebalancing plan that better meets with both efficiency and equity criteria of the Commission. Staff IB at 127.

In its Initial Brief, Ameritech Illinois asserts that Staff's principal economist, Dr. Genio Staranczak, "acknowledged that the Company should be entitled to offsetting revenue increases under the Plan." Ameritech IB at 152. Ameritech draws this conclusion on Dr. Staranczak's opinions from a series of hypothetical questions concerning the treatment of exogenous ("Z") factors in the construction of the price cap index under the Plan. Dr. Staranczak's comments were not addressing any aspect of Ameritech's rate rebalancing proposal. Rate rebalancing is not an aspect of the alternate regulation plan. Rate rebalancing is an issue that is entirely separate from the treatment of the exogenous factor under the Plan. Dr. Staranczak's responses to cross examination on this issue should not be mischaracterized in a fashion which would suggest any support for Ameritech's position on rate rebalancing.

Also, in its Initial Brief, Ameritech asserts that neither Staff nor GCI objected to its proposal to reduce Band B additional minutes charge. Ameritech IB at 153. Although Staff does not specifically object to Ameritech's proposal, Staff considers the reduction of residential Band A charges a superior way to rebalance rates in the event that rate rebalancing is necessary. When Staff proposed an alternative rate rebalancing plan in the direct phase of the case, Staff did not propose a Band B additional minutes charge reduction.

In its Initial Brief, DOD/FEA once again expressed its support of Ameritech's rate rebalancing proposal even though DOD/FEA recognizes that the proposal will result in a net increase in revenue to Ameritech. DOD/FEA at 3. This argument should be

disregarded as the outcome of a rate rebalancing should be balanced , i.e. revenue neutral, rates. The DOD/FEA goes on to state that residence network access lines are significantly underpriced relative to costs, so that those lines are being subsidized by virtually all of the company's other service offerings. DOD/FEA at 4. A subsidy exists only where the price of a service is less than its costs. Even Ameritech acknowledges that residential network access line revenues exceed LRSIC in Access Area A. Staff and other intervenors have pointed out numerous defects in Ameritech's LRSIC modeling that raise doubts as to whether a subsidy situation exists in any of Ameritech's Access Areas. The existence of any subsidy is doubtful. Different prices for business and residential services do not constitute a subsidy, contrary to DOD/FEA's assertion.

DOD/FEA goes on to restate its desire that the Commission adopt a plan which ensures that the carrier access demand charges ordered by the Commission in Docket Nos. 97-0601, 97-602, and 97-0516 are flowed through to end users by the IXC's. DOD/FEA at 7. As Staff has stated, this can be administratively burdensome and almost impossible to monitor. The Staff notes that the Commission has admonished IXC's to do precisely this in any case (Cite to something or other in 97-0601/0602). Staff's recommendation that market forces are the best way of insuring pass-through of the rate reductions is the best course.

B. Reciprocal Compensation

AT&T suggests that "...it is short-sighted for Staff to recommend, and inadvisable for the Commission to adopt, any modification to rates in this proceeding

that would cause a potentially anti-competitive solution (i.e., a reduction to reciprocal compensation charges to Ameritech based simply upon alleged inadequate revenues, rather than based on the costs of providing reciprocal compensation) in the pending ICC Docket No. 00-0555 Rulemaking." AT&T IB at 21. Staff concurs that any rate rebalancing plan should not exacerbate differences between rates and costs. That is, Staff's recommendations are based on the premise that rate reductions will be cost based. Thus, only to the extent that Ameritech's Band A rates, which are averaged over both ISP-bound traffic (the focus of Docket 00-0555) and non-ISP-bound traffic, recover revenue that exceeds Ameritech's incremental costs of providing Band A service should these rates be reduced as part of an alternative rate rebalancing plan.

C. Rate Re-initialization

Staff does not support rate reinitialization. However, Staff does recognize that the Commission has the authority to reinitialize rates and could elect to do so. Ameritech Illinois is correct that Staff recommended against price reductions for competitive services. Ameritech IB at 155. However, Staff does not share Ameritech's belief that competitive services lie outside the scope of the Commission's authority. Ameritech IB at 155. The Commission could order price freezes. Similarly, Staff would not characterize ordering all rate reductions targeted towards noncompetitive services as unreasonable contrary to Ameritech's assertion, Ameritech IB at 157 although Staff recognizes that the Commission may desire alternatives to reducing rates to LRSIC.

Also in its Initial Brief, Ameritech lists its candidate services for rate reduction. Ameritech IB at 149. Staff believes the list of services it provided for rate reduction are

superior. One great flaw of Ameritech's proposed list is that the services listed do not provide a great deal of revenue to the Company. Should the Commission adopt the full revenue requirements reduction determined by Staff witness Voss or by GCI witness Dunkel, it would be difficult to find adequate margins above noncompetitive services LRSIC to make revenue requirement reductions. Restricting rate reductions to the set of services Ameritech is suggesting would make achieving those rate reductions impossible.

VIII. CUB/AG COMPLAINT

As discussed in Staff's Initial Brief at 129-33, the CUB/AG complaint should be denied since the hearing, and the Order, in applying the standards pursuant to the issues in Docket Nos. 98-0252/98-0335 will provide the relief sought in the CUB/AG complaint.

IX. CONCLUSION

A thorough analysis of the briefs filed in this proceeding, leads to the inexorable conclusion that Staff has provided the most reasoned position in the case among the parties that have filed. Staff's recommendations carefully balance the interests of Ameritech, consumers and competitors, both actual and potential. Staff's proposals address shortcomings in the current alternative regulation plan, such as service quality, yet are forward looking and set rules and regulations that are fair, just and reasonable, and encourage competition. Finally, Staff's recommendations, if implemented, would continue to reduce the regulatory burden yet provide the Commission with the

information necessary to properly monitor alternative regulation in the future. In summary, Staff recommends the following:

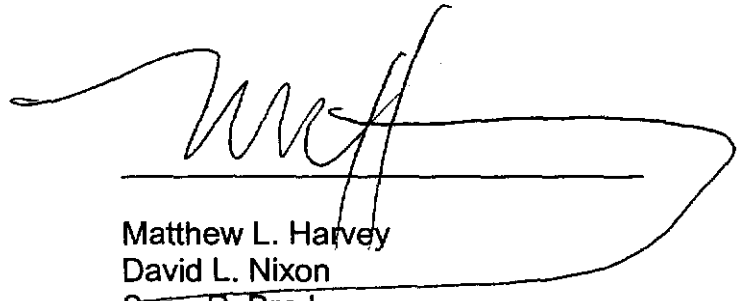
- **Rate of Return Regulation:** The Commission should not re-instate rate of return regulation.
- **Earnings Sharing:** The Commission should not implement an earnings sharing mechanism in the price cap formula.
- **Rate Re-initialization:** The Commission should not re-initialize Ameritech's rates because of the level of earnings achieved under the Plan. Nevertheless, Ameritech's revenues should be reduced by \$36.9 million to correct for the cumulative impact of (1) an inappropriate definition of "regular service installation" (\$29.5 million) and (2) incorrect classification of residential services (\$7.4 million)
- **Inflation Factor:** The Commission should adopt the chain weighted gross domestic product price index as the inflation factor.
- **"X" Factor:** The Commission should adopt a forward looking "X" factor of 4.3% which is based on a total factor productivity differential of 2.3%, an input price differential of 1% and a consumer dividend of 1%.
- **"Z" Factor:** The Commission should change the application of the exogenous factor to allow Ameritech to recoup revenues lost under externally imposed circumstances such as Commission order resulting in significant revenue decreases
- **"Q" Factor:** The Commission should remove the service quality factor from the price cap index and instead require Ameritech to directly compensate customers who are affected by poor service. This compensation should take the form of credits as well as the provision of wireless telephones under certain circumstances.
- **Baskets:** The Commission should retain the existing price cap structure of four baskets of services: Residential, Business, Carrier and Other. Residential calling plans should be moved to the Residential basket from the Other basket.
- **Pricing Flexibility:** The Commission should maintain pricing flexibility within each basket at 2% plus the percentage change in the PCI.
- **API and PCI:** The Commission should reset the PCI and API at 100.
- **Competitive Reclassification:** The Commission should impose penalties of up to \$10,000 per day for services that are improperly classified as competitive.
- **Service Quality Indicators:** The Commission should add the following service quality indicators to the alternative regulation plan (1) Percent of Installations Within 5 days (2) Percent Out of Service Over 24 Hours (3) Trouble Reports per 100 Access Lines (4) Operator Speed of Answer - Toll, Assistance and Information (Seconds) (5) Repair Office Time (6) Business Office Answer Time (7) Missed Repair Appointments (8) Repeat Trouble Rate - Installation and Repair (9) Answer Performance and (10) Missed Installation Appointments. On the other hand the following indicators should be eliminated, % dial tone speed within 3 seconds, operator speed of answer — intercept, and trunk group below objective.
- **Service Quality Penalties:** Penalties should be removed from the price cap index and be assessed immediately after a service problem develops by providing harmed consumers with direct compensation.

- **Reporting Issues:** The Commission should require Ameritech to report financial, infrastructure and quality statistics while operating under the Plan.
- **Rebalancing:** The Commission should specifically deny Ameritech's petition to "rebalance" rates.
- **CUB Complaint:** The Commission should dismiss or deny the Complaint filed by the Attorney General of Illinois and the Citizens Utility Board.

For the foregoing reason we request the Hearing Examiner accept Staff's recommendations in their entirety as set forth herein, and in its Brief filed March 22, 2001.

Dated: April 6, 2001

Respectfully submitted,

A large, stylized handwritten signature in black ink, appearing to read 'mef', is written over a horizontal line. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

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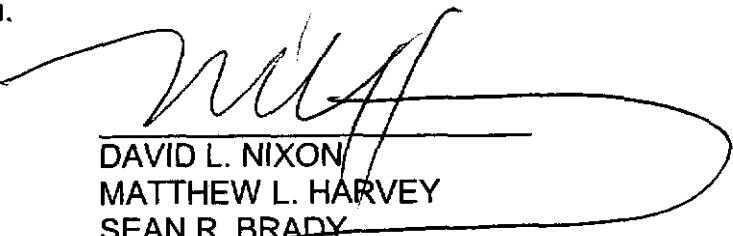
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Illinois Commerce Commission

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Illinois Bell Telephone Company)	
)	98-0252
Application for Review of Alternative)	
Regulation Plan)	
)	
Illinois Belle Telephone Company)	
)	98-0335
Petition to rebalance Illinois Bell Telephone)	
Company's Carrier Access and Network)	
Access Line Rates.)	(cons.)
)	
Citizens Utility Board and)	
The People of the State of Illinois)	
-vs-)	
Illinois Bell Telephone Company)	
)	00-0764
Verified Complaint for a Reduction in Illinois)	
Bell Telephone Company's Rates and Other)	
Relief.)	

NOTICE OF FILING

PLEASE TAKE NOTICE that we have on this 6th day of April, 2001, filed with the Chief Clerk of the Illinois Commerce Commission, 527 East Capitol Avenue, Springfield, Illinois, the Initial Brief of the Staff of the Illinois Commerce Commission, a copy of which is hereby served upon you.

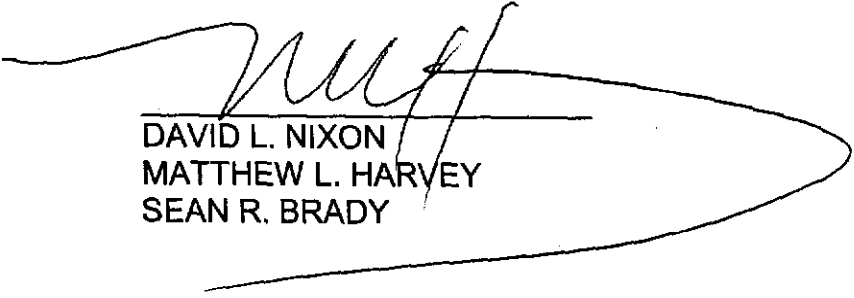


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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of the above Notice, together with copies of the document referred to therein, have been served upon the parties to whom the Notice is directed by U.S. mail, proper postage prepaid, from Chicago, Illinois, or by e-mail on this 6th day of April, 2001.



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Docket No. 98-0252 /98-0335/00-

0764.....MLH/SRB/DLN

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